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SUBJECT: 2005 INVESTMENT CLIMATE STATEMENT FOR TURKEY

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This is the first of two cables transmitting the 2005 Investment Climate Statement for Turkey:

#### 1. OPENNESS TO FOREIGN INVESTMENT

The Government of Turkey (GOT) views foreign direct investment as vital to the country's economic development and prosperity. Accordingly, Turkey has one of the most liberal legal regimes for FDI in the OECD. With the exception of some sectors (see below), areas open to the Turkish private sector are generally open to foreign participation and investment. However, all companies - regardless of nationality of ownership - face a number of obstacles: excessive bureaucracy, weaknesses in the judicial system, high and inconsistently collected taxes, weaknesses in corporate governance, sometimes unpredictable decisions taken at the municipal level, and frequent, sometimes unclear changes in the legal and regulatory environment. Historically, investment has also been discouraged by high inflation and political and macroeconomic uncertainties, though Turkey has become much more stable in the years following the 2001 economic and financial crisis.

As a result, FDI inflows, at well below one percent of GDP over the last decade, have been far below FDI received by more investor-friendly emerging markets and also below Turkey's potential. The GOT's far-reaching economic reform program agreed with the World Bank and IMF, and motivated also by multilateral agreements and EU accession, has begun to address these problems and should allow FDI inflows to grow.

Regulations governing foreign investment are, in general, transparent. Legislation approved by Parliament in 2003 (Law 4875 on Direct Foreign Investment) repealed 1954 legislation on foreign investment. The 2003 law liberalized the foreign direct investment regime by eliminating screening of foreign investors in favor of a notification system and providing national treatment in acquisition of real estate by foreign-owned entities registered under Turkish law. The law also abolished specific minimum capital requirement for foreign investments (general capital requirements apply to all companies); the requirement to seek permission from Treasury if a capital increase would change the participation ratio between the foreign investor and any local partners; and the requirement for Turkish companies to register with Treasury any licensing, management, or franchising agreements concluded with foreign persons.

Foreign investors are subject to restrictions on establishment in certain sectors. The equity participation ratio of foreign shareholders is restricted to 20 percent in broadcasting and 49 percent in aviation, maritime transportation, and many value-added telecommunication services (though telecommunications legislation has been amended to allow certain company-specific exceptions to these limits). However, companies receive full national treatment once they are established. Establishment in financial services, including banking and insurance, and in the petroleum sector requires special permission from the GOT for both domestic and foreign investors.

The GOT privatizes State Economic Enterprises through block sales, public offerings, or a combination of both. Foreign investors generally receive national treatment in privatization programs. Law 5189 of 2004 removed the limit on foreign ownership of Turk Telecom, the dominant provider of voice and other telecommunications services. The company's privatization plan foresees a block sale of 55 percent of the company.

The Turkish Parliament passed legislation in 2003 streamlining the company registration process (see Section 8 - Transparency of the Regulatory System). Another 2003 law on work permits for foreign citizens gave the Labor

and Social Security Ministry additional authority in this area (see Section 5 - Performance Requirements/Incentives). Inflation accounting was introduced at the end of 2003. Law 5177, published in June 2004, amended existing legislation on mining with a view toward making this sector more accessible to foreign investment by streamlining permit requirements and procedures and removing limits on mining on certain types of land. At the end of 2003, Parliament replaced a complex series of taxes on financial instruments with a 15 percent tax on all of them. In 2005, Turkey also plans to reduce the rate of corporate tax and to broaden the set of goods and services eligible for lower value added tax rates.

Turkish law and regulation affecting the investment climate continues to evolve. Potential investors should check with appropriate Turkish government sources for current and detailed information. The following web site provides the text of regulations governing foreign investment and incentives as well as other useful background information:  
[http://www.treasury.gov.tr/for\\_inv.htm](http://www.treasury.gov.tr/for_inv.htm). Additional information is available at:  
<http://www.investinginturkey.gov.tr>

## **12. CONVERSION AND TRANSFER POLICIES**

Turkish law guarantees the free transfer of profits, fees and royalties, and repatriation of capital. This guarantee is reflected in Turkey's Bilateral Investment Treaty with the United States, which mandates unrestricted and prompt transfer in a freely usable currency at a legal market-clearing rate for all funds related to an investment. There is no difficulty in obtaining foreign exchange. However, as the result of a 1997 court decision, the Turkish Government has blocked full repatriation of investments by oil companies under Article 116 of the 1954 Petroleum Law, which protected foreign investors from the impact of lira depreciation. Affected companies have challenged the 1997 decision and the case is currently in the Turkish court system.

## **13. EXPROPRIATION AND COMPENSATION**

Under the 1990 Bilateral Investment Treaty with the United States (codifying existing Turkish law), expropriation can only occur in accordance with international law and due process. Expropriations must be for public purpose and non-discriminatory. Compensation must be reasonably prompt, adequate, and effective. Under the Bilateral Investment Treaty, U.S. investors have full access to the local court system and the ability to take the host government directly to third party international binding arbitration to settle investment disputes. There is also a provision for state-to-state dispute settlement.

As a practical matter, the GOT occasionally expropriates private property for public works or for State Enterprise industrial projects. The GOT agency expropriating the property negotiates and proposes a purchase price. If the owners of the property do not agree with the proposed price, they can go to court to challenge the expropriation or ask for more compensation. There are no outstanding expropriation or nationalization cases.

## **14. DISPUTE SETTLEMENT**

There are several outstanding investment disputes between U.S. companies and Turkish government bodies, particularly in the energy and tourism sectors.

Turkey's legal system provides means for enforcing property and contractual rights, and there are written commercial and bankruptcy laws. The court system is overburdened, however, which sometimes results in slow decisions and judges lacking sufficient time to grasp complex issues. The judicial system is also perceived to be susceptible to external influence and to be biased against outsiders. Judgments of foreign courts, under certain circumstances, need to be reconsidered by local courts before they are accepted and enforced. . Monetary judgments are usually made in local currency, but there are provisions for incorporating exchange rate differentials in claims.

Turkey is a member of the International Center for the Settlement of Investment Disputes (ICSID), and is a signatory of the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards. Turkey ratified the Convention of the Multinational Investment Guarantee Agency (MIGA) in 1987.

Turkish law accepts binding international arbitration of investment disputes between foreign investors and the state; this principle is included in the U.S.-Turkish

Bilateral Investment Treaty (BIT). In practice, however, Turkish courts have on at least one occasion failed to uphold an international arbitration ruling involving private companies.

## 15. PERFORMANCE REQUIREMENTS/INCENTIVES

Turkey is a party to the WTO Agreement on Trade Related Investment Measures (TRIMS).

Turkey provides investment incentives to both domestic and foreign investors. These include a corporate tax exemption of 40 percent of specified investment expenses deductible from future taxable profits for investments greater than 5,000 new TL (approximately USD 3,700). (New Turkish currency was issued on January 1, 2005, with 1 new Turkish lira equal to 1,000,000 (old) Turkish lira.) Certain other incentives may require an incentive certificate from the Turkish Treasury Undersecretariat.

Law 5084, which went into effect in early 2004, encourages investment in provinces with annual per capita income below USD 1,500 as well as to high priority development regions. For low income provinces and under certain conditions, the law provides for withholding tax incentives on income tax; social security premium incentives; free land; and electricity price support. These incentives will remain in effect until the end of 2008, except for allocation of free public land, which has no expiration date. The same law also limits certain tax preferences previously enjoyed by Turkey's free zones (see below). The Turkish Government is reported to be considering expanding the number of provinces eligible for the investment incentives.

There are no performance requirements imposed as a condition for establishing, maintaining, or expanding an investment. There are no requirements that investors purchase from local sources or export a certain percentage of output. However, domestic or foreign investors who commit to realizing USD 10,000 of exports upon completion of the investment may be exempt from certain fees and taxes, such as those related to land registration or company establishment. Investors' access to foreign exchange is not conditioned on exports.

There are no requirements that nationals own shares in foreign investments, that the shares of foreign equity be reduced over time, or that the investor transfer technology on certain terms. There are no government imposed conditions on permission to invest, including location in specific geographical areas, specific percentage of local content - for goods or services - or local equity, import substitution, export requirements or targets, employment of host country nationals, technology transfer, or local financing.

The GOT does not require that investors disclose proprietary information, other than publicly available information, as part of the regulatory approval process. Enterprises with foreign capital must send their activity report, submitted to the general assembly of shareholders, auditor's report, and balance sheets to the Treasury's Foreign Investment Directorate every year by May.

With the exceptions noted under Section 1 "Openness to Foreign Investment" and Section 8 "Transparency of the Regulatory System", Turkey grants all rights, incentives, exemptions and privileges available to national capital and business to foreign capital and business on an MFN basis. American and other foreign firms can participate in government-financed and/or subsidized research and development programs on a national treatment basis. Expatriates may be assigned as managers or technical staff. We are aware of one case in the tourism sector in which denial of a residence permit has hindered operations for a foreign investor. A 2003 law (no. 4817) on work authorizations for foreign nationals gave the Ministry of Labor and Social Security more authority over work permits.

Outside of the agricultural sector and many services, Turkey generally has a liberal foreign trade regime. There are no discriminatory or preferential export or import policies directly affecting foreign investors. Turkey harmonized its export incentive regime with the European Union in 1995, prior to the start of the Customs Union. Turkey currently offers a number of export incentives, including credits through the Turkish Eximbank, energy incentives, and research and development incentives. Foreign investors can participate in these export incentive programs on a national treatment basis. More information on Turkey's trade regime can be found at [www.foreigntrade.gov.tr](http://www.foreigntrade.gov.tr).

Military procurement generally requires an offset

provision in tender specifications. The offset guidelines were modified to encourage direct investment and technology transfer.

#### **16. RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT**

With the exceptions noted in Section 1, private entities may freely establish, acquire, and dispose of interests in business enterprises, and foreign participation is permitted up to 100 percent.

Competitive equality is the standard applied to private enterprises in competition with public enterprises with respect to access to markets, credit, and other business operations. Turkey is adopting the EU's competition policy; a Competition Board was established in 1997 to implement the 1994 competition (anti-monopoly) law.

#### **17. PROTECTION OF PROPERTY RIGHTS**

Secured interests in property, both movable and real, are recognized and enforced. There is a recognized and reliable system of recording such security interests. For example, there is a land registry office where real estate is registered. Turkey's legal system protects and facilitates acquisition and disposal of property rights, including land, buildings, and mortgages, although some parties have complained that the courts are slow in rendering decisions and that they are susceptible to external influence (see "Dispute Settlement").

Turkey's intellectual property rights regime has improved in recent years, but still presents serious problems. Turkey was elevated from the Special 301 Watch List to the Priority Watch List in 2004, due to concerns about lack of pharmaceuticals data exclusivity protection and continued high levels of piracy and counterfeiting of copyrighted and trademarked materials.

Turkey's 2001 copyright law substantially modernized the legal regime, providing deterrent penalties for copyright infringement. However, it does not prohibit circumvention of technical protection measures, a key feature of the World Intellectual Property Organization (WIPO) "Internet" treaties. In addition, the Turkish courts have generally not rendered deterrent penalties to pirates as provided in the copyright law. Legislation enacted in March 2004 contains several strong anti-piracy provisions, including a ban on street sales of all copyright products and authorization for law enforcement authorities to take action without a complaint by the rightholder. However, the law also reduces potential prison sentences in piracy convictions.

In 1995, new patent, trademark, industrial design, and geographic indicator laws revamped Turkey's foundation for industrial property protection. Turkey also acceded to a number of international conventions, including the Stockholm Act of the Paris Convention, the Patent Cooperation Treaty, and the Strasbourg Agreement. The Turkish Patent Institute (TPI) was established in 1994 to support technological progress, protect intellectual property rights and provide public information on intellectual property rights, but its effectiveness has reportedly been limited by lack of resources.

In accordance with the 1995 patent law and Turkey's agreement with the EU, patent protection for pharmaceuticals began on January 1, 1999. Turkey has been accepting patent applications since 1996 in compliance with the TRIPS agreement "mailbox" provisions. The patent law does not, however, contain interim protection for pharmaceuticals in the R&D "pipeline."

Parliament amended the Patent Law in June 2004. The new law provides for penalties for infringement of up to 3 years or 47,000 new TL (approximately USD 35,000) in fines, or both, and closure of the business for up to one year. However, some companies in the pharmaceutical sector have criticized provisions that give judges wider discretion over penalties in infringement cases, delay the initiation of infringement suits until after the patent is approved and published, and permit use of a patented invention to generate data needed for the marketing approval of generic pharmaceutical products.

The Health Ministry has accepted applications to register generic copies of products which have a valid patent in Turkey; in the absence of a system for patent linkage, it may become possible for generics manufacturers to register a copy of a brand name drug with a valid Turkish patent, damaging the interests of the patent owner.

The key intellectual property concern for research-based pharmaceutical companies is Turkey's lack of data exclusivity protection for confidential test data. U.S.

industry contends that numerous products infringing data exclusivity have been approved or are pending review by the Turkish Health Ministry.

Trademark holders also contend that there is widespread and often sophisticated counterfeiting of their marks in Turkey, especially of apparel, pharmaceuticals, film, cosmetics, detergent and other products.

In 2004, Turkey published its first Plant Variety Protection (PVP) Law. However, at least one subsidiary of a U.S. seed company has been unable to obtain protection for its commercial seed under this new law.

Further information on the intellectual property situation in Turkey is available in the National Trade Estimate report, available at the U.S. Trade Representative's website: [www.ustr.gov](http://www.ustr.gov).

#### **18. TRANSPARENCY OF THE REGULATORY SYSTEM**

The GOT has adopted policies and laws that in principle should foster competition and transparency. However, foreign companies in several sectors claim that regulations are sometimes applied in a nontransparent manner.

Turkish legislation generally requires competitive bidding procedures in the public sector. In 2003, Law 4734 on Public Procurement entered into force. The law established a board to oversee public tenders, and lowered the minimum bidding threshold at which foreign companies can participate in state tenders. The law gives preferences to domestic bidders, Turkish citizens and legal entities established by them, as well as to corporate entities established under Turkish law by foreign companies. The public procurement law may be further amended in the future.

In general, labor, health and safety laws and policies do not distort or impede investment, although legal restrictions on discharging employees may provide a disincentive to labor-intensive activity in the formal economy. Certain tax policies distort investment decisions. High taxation of cola drinks discourages investment in this sector. Generous tax preferences for free zones have provided a stimulus to investment in these zones, though these preferences will be trimmed in the future (see free zones section). Similarly, incentives for investment in certain low-income provinces appear to be stimulating investment there (see Performance Requirements/Incentives Section).

Bureaucratic "red tape" has been a significant barrier to companies, both foreign and domestic. Law 4884 of June 2003 simplifies company establishment procedures. The law repeals the permit requirement from the Industry and Commerce Ministry for certain firms, institutes a single company registration form and enables individuals to register their companies through local commercial registry offices of the Turkish Union of Chambers and Commodity Exchanges. The goal is to enable registration to be completed in as little as one day and to encourage electronic sharing of documents. The government is also considering other measures to streamline other business procedures as part of its effort to improve the business climate.

Edelman